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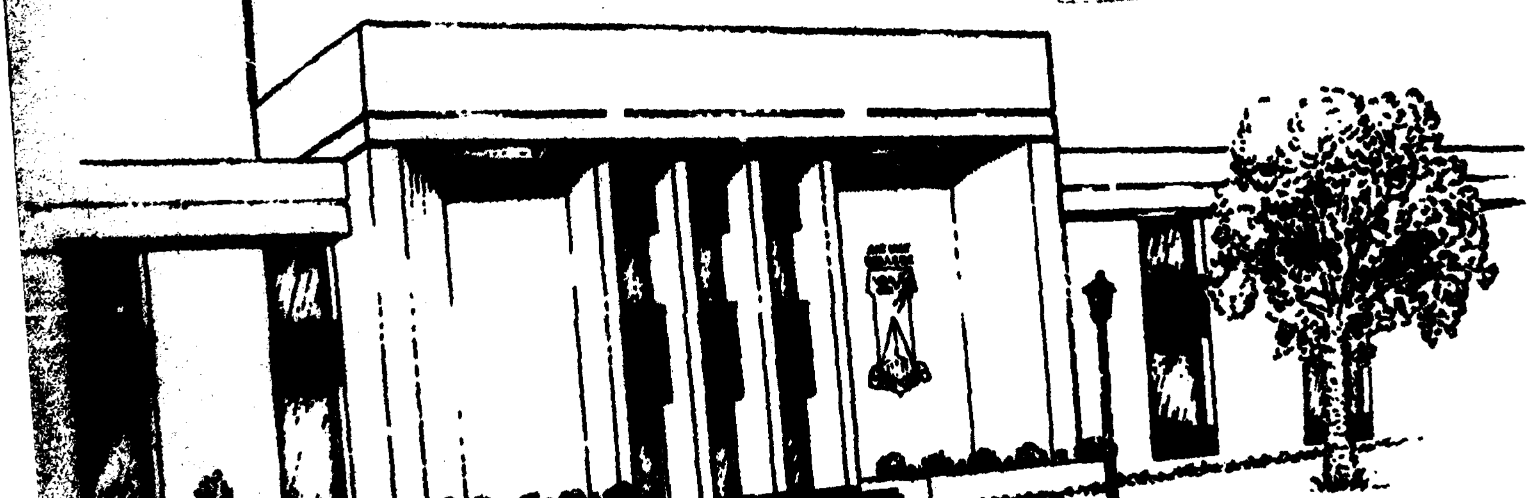
RESEARCH REPORT

LATIN AMERICA'S DEBT CRISIS:
A UNITED STATES FOREIGN POLICY CHALLENGE

LT COL GILBERT A. ENGEL, JR.

1989



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LATIN AMERICA'S DEBT CRISIS:
A UNITED STATES FOREIGN POLICY CHALLENGE

by

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A DEFENSE ANALYTICAL STUDY SUBMITTED TO THE FACULTY

IN

FULFILLMENT OF THE CURRICULUM

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MAXWELL AIR FORCE BASE, ALABAMA

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EXECUTIVE SUMMARY

TITLE: Latin America's Debt Crisis: A United States Foreign Policy Challenge

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A review of traditional U.S. national interests in Latin America and how they have changed since the 1960s introduces a characterization of Latin America today and the extent of the debt crisis that threatens the region's democratic governments. The author then analyzes and assesses two past Latin American policy initiatives--the Alliance for Progress (1961) and the Baker Plan (1985). Using lessons learned from these two programs and the current national and international environment, the author recommends a regional policy strategy to help resolve Latin America's debt crisis and further United States regional interests. Keywords: foreign policy;

BIOGRAPHICAL SKETCH

Lieutenant Colonel Gilbert A. Engel Jr. (M.B.A., Central Michigan University) has been interested in Latin America since he was stationed at McGuire AFB, NJ, and flew on Military Airlift Command missions to the region. He has traveled to Brazil, Argentina, Paraguay, Panama and Honduras. He served with the 317th Tactical Airlift Wing during Operation URGENT FURY, the 1983 liberation of U.S. college students on the island of Grenada. Colonel Engel is a 1980 graduate of the Air Force Command and Staff College and is a graduate of the Air War College, class of 1989.

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CHAPTER I

INTRODUCTION

The Honorable Elliott Abrams, Assistant Secretary for Inter-American Affairs, stated in 1987:

> A key element of this (Reagan) Administration's foreign policy has been the recognition of the importance to our national security of our own hemisphere....We have taken great satisfaction in the remarkable trend toward democracy taking place in Latin America and the Caribbean. We have supported this trend, not only because it is in accord with our deepest values but also because we believe it is in our interest. (1:32)

Exactly what are our national interests in Latin America? Why is this region of security concern to the United States? Have our regional interests changed in the last 20-30 years?

U.S. Regional Interests

Traditionally, Latin American importance to the United States has been defined in terms of security, political and economic concerns. Security concerns have been foremost--protecting the United States against direct military threats to itself and its military assets in the region, protecting vital maritime routes like the Panama Canal and assuring access to strategic raw materials. Political interests, of secondary importance, included

winning Latin American diplomatic support in various international forums and enhancing ideological harmony in the Western Hemisphere. Economic interests generally meant assuring favorable treatment for U.S. trade and private investment. (23:2)

That traditional approach of the 60s and 70s has changed due to changing world realities. First, security concerns. As time has demonstrated, the fear of widespread communist insurgency throughout Latin America after Fidel Castro took power did not materialize. While Cuba is still Communist, it has proven to pose no direct threat to the United States. The Panama Canal is still important strategically, but it too has become less important as the physical size of our maritime fleet grows. Today, the thrust of our regional security concerns is more along the lines that, "a friendly southern flank that does not drain U.S. resources is considered to be fundamental to the nation's ability to project its power and influence elsewhere." (26:97) The aim of preventing Communist forces from gaining a further foothold in the Western Hemisphere remains important, as evidenced by our attention with Nicaragua, but not as all-consuming as it once was.

Today, Latin America is also less significant in political terms. Latin American nations have become stronger, more assertive, more nationalistic and thus more independent. As we now frequently witness in the United Nations, Latin American nations decide "North-South" as well as "East-West" issues in terms of their own individual national interests. In such international arenas, "That once Latin American bloc united in support of US foreign policy is no longer attainable." (23:7)

In economic terms, the emphasis has also shifted but in the reverse direction. While the traditional factor of direct U.S. business investment in Latin America has declined, banking interests have increased as a result of Latin America's massive borrowing from US banks and international institutions. Further, because both Latin America and the United States have become more involved in the world economy, Latin America has become increasingly significant as an important economic market for US exports. The region now accounts for up to a third of our total annual exports. (35:A1) Mexico, for example, is "our fourth-largest trading partner and our most important foreign supplier of oil." (19:59) The economic impact of the region is best exemplified in the 1981 through 1983 drop

in U.S. exports to Latin America (from $39 billion to $22.6 billion respectively). That drop is conservatively estimated to have cost the US at least half a million jobs. (23:10) As a result, a strong case can be made for the statement, "Renewed US prosperity depends to a considerable degree on global recovery, including that of the developing countries, and particularly of the advanced developing countries clustered in Latin America." (23:9)

Latin America

A more definitive definition and characterization of Latin America today is needed. Latin America extends from the U.S. southern border with Mexico to Cape Horn on the southern tip of South America. The region is over two and one-half times the size of the United States, contains 15 per cent of the world's land mass and 390 million people, or 10 per cent of the world's population. Collectively, Latin America today, can be synthesized into two broad and somewhat contradictory trends. First, political instability and authoritarianism of the 1960's and 70's have been replaced by growing universal democratic politics. Over 90 per cent of the region's population today are governed by democratic leaders. (19:54) Second, the region's rapid

economic growth experienced during the same period has given way to a prolonged economic crisis. "These two major tendencies--one hopeful, the other deeply troubling--frame the context of United States-Latin American relations in the late 1980's." (24:1)

Because of internal economic failure, dwindling popular support and adverse international opinion, the repressive authoritarian regimes of South and Central America in the mid to late 1970's began to crumble and gave rise to democratic governments. Today, of the major Latin American countries, only Chile, Paraguay, Nicaragua, Panama and Cuba still have authoritarian or communist regimes. This democratic trend, while broad, is however, "very fragile, vulnerable to economic collapse, social strain and political extremism." (24:2) Uruguay, Bolivia, Ecuador, Columbia and even Venezuela are but a few examples of countries that have experienced either periods of military coups, rebel seizure of government buildings, or failing standards of living that have seriously weakened public trust and support.

Regional Debt Crisis

The most significant democratic vulnerability facing Latin America today is a prolonged, growing economic

crisis. To understand the problem, one must understand its origin and severity.

During the 1960's and 70's, as billions of petrodollars were deposited into Western financial institutions by oil-exporting countries, these commercial banks loaned billion's to oil-importing countries to finance national deficits caused by "living beyond means" fiscal management. Neither the borrower nor the lender put much emphasis on restraint. Between 1972 and 1979, the indebtedness of the Less Developed Countries (LDCs) increased at an annual rate of 21.7 percent. By 1984, the gross external debt of Third World countries exceeded $800 billion, almost double that of 1979. By 1986, Latin American external debt alone totaled $382 billion--almost half of the total indebtedness of all developing countries. In 1987, the region's external debt topped the $400 billion mark. Brazil and Mexico each owe over $100 billion; Argentina over $50 billion. (9:1,48:1,24:3,6:261)

If the dollar amount of the debt isn't staggering enough, other factors highlight the seriousness of Latin American's financial crisis. Annual interest payments on the debt's principal equal 35 percent of Latin American

export earnings (higher than the Third World average of 20-26 percent). Stated another way, more than one-third of Latin America's export earnings are devoted annually just to meet interest payments on these loans. And, Latin American export drives to improve the ratio of debt to exports, a standard measure of the capacity to repay, have not succeeded. (24:3,9:1)

Compounding the debt and debt service burden, inappropriate domestic economic policies have imposed serious constraints on internal growth and development. Lack of confidence of these policies has dried up domestic savings and investment (down about 25 percent during the 1980s in the region as a whole) and has led to huge capital flight in many countries. Total capital flight for Latin America since 1979 is estimated conservatively to have exceeded $100 billion. Thus, while capital flight on a massive scale diminishes Latin American domestic investment (their ability to provide economic growth), about one-fourth of Latin America's essential savings are siphoned off each year for interest payments on its existing debt thereby further reducing funds available for investment. (24:3,9:1) In essence, Latin American economies are caught in a vicious circle from which no Latin American nation's economy has yet

managed conclusively to escape the debt trap. (24:3)

What is the significance to the United States of this crisis that threatens economic recovery in virtually every country in Latin America? The answer lies in the inherent advantages of having stable, secure, economically prosperous, democratic nations in Latin America as fully participating partners in the world community. Helping to ensure the stability of these regional democracies is in our national interest because such institutions, "1) adopt or generate free market-oriented economies; 2) respect human rights; 3) are more stable politically; and 4) are unlikely to actively threaten U.S. security interests." (52:3) However, the current financial crisis threatens the very fiber of those newly formed democracies and in turn our national security interests. As reported in a recent newspaper article,

> Latin American officials are now warning that in country after country, falling living standards (caused by the strain of huge debt payments) are breeding a hopelessness that is beginning to translate into ominous political decay....military takeovers cannot be discounted in the next year or two in several countries that only recently returned to civilian control....the single issue that unites Latin America is debt, because from Mexico to Argentina, from Brazil to Peru, this problem is held responsible by governments for their crumbling popularity and is seen as the key political variable affecting their immediate future. (35:A1)

Having established that Latin America as a region is of significant national interest for its economic partnership, and given the fact that while, "the United States no longer exercises overwhelming predominance in the Americas, but it is still by far the Hemisphere's most important actor," (24:43) what is the best course of action for the United States to help resolve this regional crisis?

The purpose of this paper is to recommend a course of action for the United States that will help resolve this threat to the newly formed democratic governments of the region and the stability of the region as a whole. The approach used will be to assess the effects of our last two significant Latin American policy initiatives; namely, the Alliance for Progress (1961) which was a Kennedy administration regional economic and social development program initiative, and the Baker Plan (1985) which was a Reagan administration proposal to resolve this same debt crisis. Using the lessons learned from the Alliance for Progress and the Baker Plan, and the current state of affairs in the United States as well as Latin America, the author will then recommend a specific course of action.

Throughout this paper, the issues address the region

as a whole--Latin America (Central and South America). While each nation's situation varies; e.g. extent of indebtedness, democratic form of government etc., it is important for the United States to formulate and to articulate a comprehensive, debt solution policy for the entire region.

CHAPTER II

THE ALLIANCE FOR PROGRESS

Twenty eight years ago, President John F. Kennedy proposed and set in motion the Alliance for Progress, a ten-year economic and social development program for Latin America. Why?

> In part, it was established as a reaction to Castro's astounding successes in Cuba and to the little bubbles of activity all over Latin America seeking to emulate the Cuban experience. In part, it reflected the treatment accorded Vice President Richard Nixon on his famous tour of South America in 1958, which startled United States citizens into an awareness that all might not be well south of the border. In part, too, it reflected the outstanding accomplishments of the Marshall Plan under which the United States had successfully contributed critical assistance for postwar recovery in Europe. (16:257)

During the early 1960's, it was widely believed that Castro's Cuba represented an advanced base of Soviet threat to U.S. interests in the hemisphere, that Latin America was "one minute to midnight" from either "evolution or revolution" and only U.S. support for far reaching reforms could stave off shattering violence and communist growth in the region. (22:495) To counter this national security threat, President Kennedy's proposal was transformed into the Charter of Punta del Este, signed on August 17, 1961, by

the United States and the nineteen major Latin American nations.

Goals & Objectives

The Alliance for Progress was a decade-long (1961-1971) cooperative multinational development effort, "to lift Latin America economically, reform it socially and help it settle down politically." (49:66) Latin American nations agreed to initiate large-scale self-help economic and social reform measures by preparing and implementing solid development plans, and by undertaking substantial structural reforms--especially of land tenure and tax collecting systems. (44:723,46:1,16:257) Specific Alliance goals included, for example:

> A minimum increase in per capita economic growth of 2.5 percent a year....to accelerate agricultural and industrial development....to speed the process of economic integration....to carry out extensive land and tax reforms....to make the benefits of economic progress available to all citizen's of all economic and social groups....to eliminate adult illiteracy....and to construct vast, new health, housing and educational facilities. (47:39-46)

To finance this undertaking, Latin American signatory nations agreed to contribute $80 billion. In return, the United States set a goal of $20 billion in economic aid and investment from abroad. The U.S. cost was

thought worthwhile because, "It was assumed that economic growth, social equity, political stability and constitutional democracy all went hand in hand and could therefore be advanced simultaneously in Latin America." Also, for reasons already discussed, the Alliance objectives were thought to be compatible with protecting various U.S. interests in the hemisphere, including national security. (22:496,49:66)

Almost three decades have elapsed since the Alliance for Progress was officially created. Many articles have been written from both sides of the U.S. southern border analyzing the successes and failures of the program. As a means of assessment, this paper will now coalesce those perceptions.

Accomplishments

By 1969, the Alliance for Progress had reached its zenith in terms of monetary obligations and accomplishments. By then, total United States outlays under the program exceeded $9 billion while U.S. businessmen invested another $3.2 billion. With this and $115 billion invested by Latin American countries themselves, an impressive number of schools, hospitals, clinics, roads and dams were built. Through U.S. prodding, nine countries

revised their tax structures, tax collections improved and public revenues rose. As a result, the Alliance spawned new savings and loans with local deposits exceeding $300 million. Public administration was modernized. Water supply and sanitation projects reduced health hazards to over 25 million Latin Americans. Primary school enrollment increased by over 50 percent and secondary school enrollment increased by 100 percent since 1960. The Alliance provided surplus food for 25 million people, new homes for 1.5 million, classrooms for 1 million pupils and over 8 million school books. Land reform measures were enacted in several countries and all nations subscribing to the Alliance, except Haiti, enacted varying active planning bodies fostering development institutions and projects on a national level. Also, by 1967, 7 of the 19 Latin American republics had met or exceeded the charter's per capita economic growth rate target. (49:67,32:245,42:429,45:15, 50:8,34:10,14:5,13:3,39:15)

In 1967, on the sixth anniversary of the Alliance for Progress, Mr. Sol M. Linowitz, United States Representative to the Organization of American States, stated,

There have been more tax reforms, land reforms, schools built, students trained, roads built, new institutions created in Latin America in the past 6 years than during any previous decade. In land tenure, tax and administrative reforms, there has been greater progress during the past 6 years than in the previous 25 years.... (20:322-23)

However, like many who examined the Alliance for Progress, Mr. Linowitz also went on to state,

It would be nice to say ...that the Alliance is fulfilling all the dreams of its founders; that Latin America is well on the road to prosperity; that its people have already succeeded in building new lives for themselves and for their children; that they have overcome such problems as low standards of living, soaring birth rates, lack of opportunities, underdeveloped industrial and agricultural potential, insufficient housing, lack of schools,...It would be nice to say, but it would, of course, be untrue. Latin America is still in the grip of far too many economic problems and social conditions that conspire to arrest progress and frustrate dreams. (20:322)

Reasons for Failure

This statement accurately reflects not only the growing frustration with the Alliance for Progress, but also the growing acknowledgement of the program's failure. As the remainder of this chapter will establish, the reasons behind that failure were many.

The Alliance for Progress was viewed by many, especially those within the United States, as a Latin American Marshall Plan. While both were multi-billion dollar, multi-year, internationally coordinated programs,

the similarity stopped there. The Marshall Plan supplied economic reconstruction aid to social-political-economic institutions already in existence and already oriented to serving the welfare of most of their people. The political-social-economic systems in Latin America however, evolved primarily to protect, to educate, and to maintain the already privileged (the "haves"). The Alliance for Progress was designed to change that latter system. Further, the Marshall Plan did not contend with the great geographical, economic and social diversity found in Latin America. Unlike Western European nations, Latin America lacks significant traditional intra-regional trade partially resulting from inadequate transportation and communication facilities, their economies are predominately agrarian and therefore not conducive to extensive intra-regional trade and reconstruction type reform, and great differences exist in national levels of development. The Latin American problem was more complex requiring construction not European style reconstruction economic aid. Therefore, the Marshall Plan model was simply not appropriate for a non-homogeneous, non-industrialized region like Latin America in the 1960s where despite some similarities, there was no typical Latin

American country. (16:258,48:30,33:66)

A clear distinction between Latin American "haves" and "have-nots," best illustrated in terms of land ownership and taxes is appropriate at this point since it's basic to understanding the failure of the Alliance for Progress.

In Latin America, in the 1960s, an estimated 90 percent of the cultivated land was owned by 10 per cent of the land owners. (46:4) Land owner interests were not in food crops but big profit, exportable cash crops such as coffee. The peasants who worked these haciendas covering thousands of acres did not receive cash but rather food, shelter and clothing. Thus, the peasant workers were entirely dependent on the land owners and great disparity existed between the few "haves" and the many poorer "have-nots."

Tax revenues in Latin America have historically been in the form of sales tax rather than graduated income tax. Therefore, the tax burden had fallen more heavily on lower, least able to pay income groups. Compounding that burden was income tax evasion by the rich. As one Latin American official commented, "Not a single Latin American, whether of high standing or of the underworld, has ever been imprisoned for not paying his taxes or for sending in a fraudulent

income tax report." (34:11) "Tax evasion is widespread....There are many extremely well-to-do and even very rich people who pay no taxes; they have recourse to all sorts of anachronistic though still legal loopholes." (7:33)

Given the governmental control of the "haves," it's not surprising little substantiative progress was made in three key areas of the Alliance--education, land reform and tax restructuring. To do otherwise, the wealthy elite decision makers would have to vote higher taxes on themselves, undertake fundamental land reform and encourage educational reform which would allow newly-educated citizens to gain power. Instead, Latin American officials literally paid lip service to the need for reform, reluctant to give up the privileges that reforms would bring. Indeed, by 1966-67, the trend was unmistakable. National development plans, while on the books, were either not transformed from grandiose statements into realistic implementation plans or did not contain a single measure looking toward a transformation of the social structure. Similarly, while 14 nations had passed agrarian reform laws, only in two or three countries were these reforms aggressively

implemented. As a result, land distribution was slow, tax reform limited and many other promised reforms unaccomplished with the victims being the Latin American people. (2:17,49:68,22:499,45:16,28:441)

This begs the question, "Were the Latin American signers of the Charter of Punta del Este fully committed to the conditions and implications of the Alliance for Progress?"

> In Latin America, perhaps more than anywhere else in the world, political leaders have a habit of carrying revolutionary statements beyond the point to which they are really prepared to go. That practice does not generally have any serious effects on internal politics. But international politics is quite another thing, since every word is reckoned, or ought to be reckoned, at its face value. We can, then, be reasonably sure--as indeed the event has proved--that when the governments pledged themselves to change fundamentally certain traditional structures in the political, social and economic life of Latin America--as in the case of agrarian reform--they were not yet absolutely determined to carry all this out. (7:31)

Time and evidence clearly indicates that collectively Latin America's leadership was not committed to the Alliance goals. Understanding of what they and their power base had to loose helps explain the unwarranted delays in implementing reform programs and why Alliance successes were limited to short-term welfare type gains such as providing food and building schools and health clinics.

Indeed, in 1967, on the fifth anniversary of the Alliance for Progress, Chile's President Edwardo Frei stated,

> The problem is that what was fundamental to the Alliance for Progress--a revolutionary approach to the need for reform--has not been achieved. Less than half of the Latin American countries have started serious programs of agrarian reform. Drastic changes in the tax system are even scarcer....In other words, there has been no strengthening of the political and social foundations for economic progress in Latin America. This is the reason why the ultimate objective of the Alliance--the formation of just, stable, democratic and dynamic societies--is as distant today as it was five years ago. (28:443)

Ironically, what limited gains were made were virtually erased by Latin America's rapidly expanding population. In Latin America from 1961-1965, the population increased by more than 20 million people. Compared with a 1.7 percent annual population increase in the United States, Latin America's population grew by an average 2.8 percent annually (3.3 percent in some countries). (46:2) Urban population increase is most illustrative. "In 1960, Latin America's urban population numbered about ninety three million persons; five years later, the figure had climbed to one hundred and fifteen million." (13:3) While the Gross National Product (GNP) in most of these countries was indeed growing, GNP did not grow fast enough to appreciably raise aggregate per capita income. In fact, given the 2.8 percent

annual population increase, the minimum rise in per capita GNP had to be 5.3 percent annually to attain the Alliance's target of 2.5 percent economic growth. "In other words, the people on the average have scarcely any more food, housing, and goods of all kinds than they had a few years ago, and in some countries they have less." (46:2)

Population growth likewise eroded the gains in housing and education. While, under the Alliance, 2 housing units per 1,000 persons were being built, 12 dwelling units per 1,000 persons every year were required. While Latin American primary school education increased 58 percent, secondary school enrollment 110 percent and college enrollments 90 percent, school age populations were growing even faster. By 1966, there were 30 million more illiterates in Latin America then there were when the Alliance for Progress began. (49:68-69)

Financial considerations also factored into the final abandonment of the Alliance for Progress. To raise its monetary commitment, Latin American countries had to rely on export earnings exceeding import outlays. However, because of unstable market prices of the 1960's which generally lowered prices for their principal regional export commodities (sugar, coffee, bananas and meat), the export

gains realized were due solely to a significant rise in export volume. However, Latin American export earnings generally did not keep pace with the rise in the cost of imported finished goods and services so desperately needed for development. An example best illustrates the point,

> In 1954, the price of coffee was eighty cents a pound. In that same year, a jeep was worth $1,367. In other words, fourteen bags of coffee bought one jeep....Today (1969) the price of coffee is forty cents a pound, and the price of a jeep is $2,264. Now, it takes forty-three bags to buy a jeep... (3:43)

Most of the U.S. pledged Alliance "aid" came not in the form of grants but in long term loans that had to be paid back. During the period Aug 61 to Dec 67, U.S. credits amounted to $5.85 billion. However, the same Latin American borrowing countries paid back $2.1 billion plus $0.7 billion in interest. Thus, net credits from the U.S. during this period really only amounted to $3.0 billion. (39:15) Emotional rhetoric disagreement began to surface over what Latin American's saw as insufficient financial outlays by the United States and a common U.S. tendency to lump all monies destined for Latin America (uncoordinated emergency loans to prop up U.S. backed governments, military aid etc.) as Alliance aid. (28:444)

Simultaneously, many of Latin America's wealthy

shipped vast sums of money to foreign bank accounts, further decreasing available internal investment capital. Capital flight exceeded one or one and a half billion dollars in 1963 alone. (41:1)

The net financial impact now begins to take shape. "Latin American nations filled the gap between their development needs and the available funds and long-term financing with short-term, high interest supplier credits." (13:4) Consequently, Latin American external debt service payments (interest and principal) ballooned from $150 million annually (1955-60) to nearly $2 billion annually in 1965--ten times higher. (13:4-6) Although Latin American nations exceeded their Alliance financial commitment (by 1968 Latin America had contributed $115 billion), export-import price disparities and the growing debt problem were ominous storm clouds on the horizon.

Not surprisingly, Congressional and Presidential support in the late 60s began to wane as reflected in reduced U.S. monetary commitments--from $1 billion annually in earlier years, to $506 million in 1967, to $470 million in 1968 and $336 million in 1969. (18:54) President Nixon and others in 1969 concluded that economic growth in Latin

America under the Alliance, as a result of an unchecked population explosion and a disappointing 1.4 percent aggregate per capita growth rate, had been less than it was during the previous two half decades (1950-55 and 1955-60) and had been less than that in non-Communist Asia or in Communist East Europe. (31:20,49:68,22:498) Stated another way, other Third World regions were making as much if not greater gains without an Alliance for Progress.

In summary, the fear of Cuban inspired communist expansionism within the hemisphere because of Latin America's exploitable condition as a virtual microcosm of all the problems of a "have-not" world, and the post World War II success of the Marshall Plan led to the Alliance for Progress initiative. Through the Alliance for Progress and with internal self-help initiatives, these Latin American countries would develop and implement tax and land reforms and economic growth programs that would benefit the people who needed it most. The envisioned result would be a modern, economically viable and socially progressive Latin American society with democratic governments and foreign policies coinciding with the interests of the United States. But, the Alliance was based on false premises,

First, that the combination of popular pressure,

economic pressure, US aid and fear of Castro would compel the oligarchy (of land owners) to give up its political power and part of its economic privileges; second, that it would be possible to carry out a successful development program with widespread social changes.

The oligarchical interests were not afraid of Castro. Fear of Castro was limited to the United States....Thus, the oligarchy refused any social reform other than the most superficial gestures.

The Alliance had to find something to do. Since it could not put across any real reforms, it built hospitals, houses, etc., which the Latin American governments could reasonably have been expected to do themselves. Hence, the Alliance became simply another foreign aid problem. The Latin American governments (all oligarchies save three) succeeded in detouring the Alliance away from its original goal, making it powerless to bring about social change, deceiving those who had faith in it, and using it to make the United States foot the bill, while at the same time they reproached the United States for providing "inadequate" aid. (2:17-18)

Lessons Learned

What are the lessons learned from the failure of the Alliance for Progress? And, how might they be applied to Latin America's current debt crisis? First, although not a direct factor in its ultimate failure, the goals of the Alliance for Progress were acknowledged early on by most charter cosigners as clearly too ambitious to be accomplished within a single decade. Thus, in any proposed solution to the current debt crisis, attention must be paid to the questions, "What goals are to be established and are they attainable? And, how long will they take to be

achieved?" United States support for the Alliance for Progress waned after six to seven years. Can the U.S. expect strong popular support for a debt resolution strategy which forecasts program duration of a decade or more?

Second, the Marshall Plan analogy was inappropriate for Latin American application. The failure of the Alliance for Progress causes one to remember that just because one solution worked in one situation is no assurance it will work in another time or place or with different participants. One must carefully consider regional geographic, cultural and political differences and not ignore those differences nor assume they are insignificant. The decision maker mentality and motivational differences between West European post World War II leaders and Latin America's oligarchies illustrate the point. Similarly, post World War II Europe had and needed a growing population to act as a force multiplier in economic recovery. Latin America also had a growing population during the Alliance for Progress years. However, Latin America's growing population was a detriment and a contributing factor in its failure. Due to the growing interdependency of national economies and the world economic market, can the U.S. expect that a debt resolution strategy that attempts to manipulate

that relationship to work? Are economic market conditions so interdependent, that any attempt to manipulate the economic system is certain to cause undesirable consequences and eventual failure? Is there a better way to approach the problem? And, how does Latin American commitment, capability and resolve fit into the strategy equation?

Lastly, although less a contributor, internal investment capital and Latin American feeling that U.S. aid fell short of expectations played a factor in the final outcome of the Alliance for Progress. In an era of even more creative types and forms of aid, grants, short-term and long-term loans, private investment, and multinational investment, can the U.S. expect monetary commitments to be any less complicated or emotionally destabilizing in terms of disagreement potential? Further, in today's national and global economic environment, which at best forecasts a period of limited economic growth, does the U.S. possess the fiscal capacity and will to commit billions of dollars like those obligated in the Alliance for Progress?

CHAPTER III

THE BAKER PLAN

During the 1960s, as the Alliance for Progress initiatives attempted to transform Latin America economically and socially, the region's external debt grew to a relatively modest $2 billion. In the 1970s, Latin America experienced a period of unprecedented growth that was fueled by massive commercial borrowing spurred by very low international interest rates. As a result,

> In a climate of rapid growth and easy credit, the region's indebtedness grew to more than tenfold between 1970 and 1982, from $27 billion to about $300 billion. The cost of servicing that debt soared in the early 1980s as interest rates rose to record levels. At the same time, Latin America's capacity to meet its obligations dropped precipitously when global recession cut deeply into export earnings and the region's access to commercial credit was sharply curtailed. (19:46)

By 1985, foreign debt continued to be fueled by the combination of high interest, falling export earnings, limited access to new loans and internal economic mismanagement. (19:46) The external debt of 15 middle-income developing nations alone had risen to an alarming $437 billion, of which $275 billion was owed to commercial banks ($94 billion to US banks). As the

attachment indicates, 10 of the 15 (two-thirds) of the most externally indebted Third World nations were Latin American. Collectively, their debt exceeded $350 billion. (21:98,11:52,27:10)

Up to 1985, the US government policy concerning the rising Third World debt was that foreign countries should solve their economic problems by adopting strict austerity measures and by paying off those loans with the minimum of external government help. However, "It was hardly good policy to push austerity programs that fostered social unrest in Latin America at a time when the U.S. was fighting Communist-backed revolutionaries in the same area." (15:64) Also contributing to the administration's decision toward a markedly different position was the fear that an anticipated world economic slowdown in 1986 combined with Third World debt and the real possibility of international loan defaults (in countries like Mexico, Brazil and Peru) would precipitate a world financial crisis and possible global depression. (8:47)

Key Provisions & Objective

Thus, on 8 October 1985, in Seoul, Korea, at the annual meeting of the World Bank and International Monetary Fund (IMF), United States Treasury Secretary James A. Baker

III presented the Reagan administration's new proposal to resolve the global debt crisis. The Baker Plan was a proposed three year $29 billion foreign aid fund program. The plan, which was now the administration's new economic instrument to help attain our broad foreign policy objectives of promoting domestic prosperity and furthering our democratic values, (43:38) contained three key provisions; namely,

1. "First and foremost, the adoption by principle debtor countries of comprehensive macroeconomic and structural policies to promote growth and balance-of-payments adjustment, and to reduce inflation." (5:10) Such changes would include internal economic policies that discourage capital flight, attract foreign investment and result in the divestment of state-owned industries.

2. The World Bank and other multilateral agencies would play a bigger role in restructuring debts of Lesser Developed Countries (LDCs) by increasing their lending by an additional $9 billion over the next three years, and

3. Commercial banks would increase lending to LDCs by $20 billion over the same three year period. (40:35,15:62,5:10-11)

The objective of the Baker Plan was a "Program for Sustained Growth" to rescue the Third World debtor countries. (5:10,15:62) Sustained growth requires economic growth which requires the debtor countries to grow out of their debt. "To do so, they will need even more cash infusions." (15:62) Thus, the Baker Plan was to provide that cash infusion thereby allowing economic growth and ultimately a firm financial footing for these countries. While the Baker Plan addressed the larger global problem, the principal "beneficiary" region was Latin America.

<u>Strength</u>

The strength of the Baker Plan lay in the increased monetary and supervisory role of the World Bank. The World Bank would "fill the gap left by the IMF whose loans and austerity programs aimed at short term gains." (15:62) Perhaps more important however, the Baker Plan was viewed by many bankers as a constructive first step that specifically addressed two key debtor nation problems; namely, capital flight and private sector orientation. (11:54,90)

Why was resolution of these two issues important to the lenders? From 1983-85, $30.8 billion left 10 Latin American nations while net borrowing for these same countries amounted to $44.2 billion. As one banker said,

"If a country's own citizens have no confidence in its economic system, how can others?" (36:90) What wasn't borrowed to replace internal investment capital lost by capital flight was often borrowed to finance faltering state owned holding companies, which are routinely less growth oriented and more wasteful than private enterprises which work on a profit margin basis. Earlier loan conditions encouraged divestiture of these costly state holding companies but little progress was actually made, therefore contributing to the worsening debt problem of individual nations.

Weaknesses

Conversely, there were plan weaknesses. Many commercial banks were reluctant to make new loans to LDCs since they had either written down their foreign loans over the last several years to reduce their exposure, or already had "mountains of rising Latin American loans outstanding." (21:101) Bankers were, "hardly enthusiastic about a plan that in effect will make them even more exposed to Latin debt." (37:37) To the commercial banks, "Why become trapped in loans of extended maturity, made to sovereign borrowers, which the banks could not force to pay," and "in the end

will pay only what they (the foreign countries) want to pay." (21:98,102)

These same bankers asked, "Where's the tradeoff? What will we get in return? The answer seems to be 'nothing'." (11:90) No US or World Bank guarantees were attached to these new loans. As some bankers stated concerning the $20 billion, "If you strip away the rhetoric (of the Baker Plan), the only substantive part is that banks have to lend more money." (40:35)

Many debtor countries also opposed the plan. Conditional on receiving these loans, foreign countries had to make more internal economic "belt tightening" changes. These countries contended austerity programs already imposed were real hardships that seriously threaten their democracies. They felt they had "pushed austerity to the limit and cannot go further without causing severe hardship." (8:47)

Besides voiced concerns from both the lender and the receiver, the plan had several internal weaknesses. To raise $20 billion from commercial banks entails obtaining cooperation from over 700 banks in over 50 nations. Second, like the IMF, "the World Bank is an imponderable: conservative, methodical, bureaucratic, a big borrower in

the financial markets and therefore super protective of its credit rating (AAA)....few countries met its standards of credit worthiness." (21:101) Therefore, it would take time to get the $20 billion commitment from the commercial banks. And, before the World Bank would lend its $9 billion, the borrower would have to show that it had indeed implemented the restrictive loan conditions.

<u>Assessment</u>

Was the Baker Plan a success or failure? Three years after James Baker first unveiled his plan, published articles indicate only one of the 15 targeted countries has borrowed money under the plan. The rest have either somehow met their payment schedule at the "11th hour," separately renegotiated existing loan conditions, or in the case of Peru, flatly stated that the debt repayments would not exceed "X percent" of export income.

Because of decreasing oil export dollars due to reduced world oil prices and because of its devastating earthquake, Mexico had little choice but to reach agreement to borrow $13 billion on top of its already staggering $98 billion foreign debt. Why only Mexico? A closer examination of the problem will disclose the answer.

Foreign countries have two ways to raise hard currency to pay the interest and principal on their foreign debt. First, Option A, they can "do-it-yourself" by exporting more than they import and therefore raise needed cash. Second, Option B, they can get outside help and borrow more money. (21:100) In 1982, when on a case-by-case basis additional commercial loans were negotiated with these debtor nations to meet near default annual payments, future long term prospects for these countries looked good. Indeed, in 1984-85, these 15 countries in the aggregate had a $44 billion export to import surplus. Thus, they could meet their annual payments. Not so after 1985. Because of the sluggish world economy in 1985-86, this same export to import aggregate for the same 15 countries was only $35 billion. That's not nearly enough currency to pay the $45 billion owed ANNUALLY just in INTEREST PAYMENTS. (21:100)

Option B, the outside help method, involves a "borrowing from Peter to pay Peter" principle. (21:100) The banks lend additional money, which the foreign country then uses to pay its existing annual interest payments (not principal). Therefore, the money comes right back to the banks (Peter). The problem is that the debtor country now has an even higher foreign debt (with roughly 10 percent

interest), while simultaneously the banks get deeper into a quagmire of questionable value loans.

Four reasons surface as to why 14 of the 15 foreign countries did not borrow under the Baker Plan. First, the obvious--Would you willingly borrow more money knowing it would put you further in a "financial hole"? Second, the Baker Plan had very specific austerity programs or strings attached to the loan conditions. Many debtor countries did not feel the additional austerity conditions were worth it, since austerity measures already imposed following the 1982 negotiations did not provide sufficient capital to address growing basic demands of their citizens; e.g. food shortages, mounting crime, growing rural and city poverty, widespread malnutrition, and rising infant mortality. (19:47) These democratic governments throughout the region were simply losing popular support because they were unable to confront their internal social problems. Third, as mentioned earlier, the banks have been and apparently still are reluctant to "throw more money down the well." If these same banks had been willing to lend the needed capital in 1985, Baker would not have needed to unveil his plan in the first place. Fourth, the Baker Plan was simply a short term

fix to raise the funds needed to make the "round trip" payments. It did not address the bigger problem of the loans themselves and how to either lower the principal owed or the percentage of annual interest. Thus, the lender was reluctant to lend and the borrower was unwilling to borrow.

Perhaps equally contributive of the Baker Plan's failure though was the fact that once the decision was made to not address the debt itself, there was also no attempt to address how the economic climate and US domestic market conditions could be altered to better these debtor nation's ability to repay these loans. Economically, how goes the US, so goes many debtor nations of the world! Why? The answer is simply that to raise the needed export dollars, these countries must export primarily to the largest world consumer market--the United States. However, with the huge US budget deficit and no strong commitment to reduce it, added to high interest rates (resulting from the same US budget deficit) and topped by US protectionist measures, foreign country export markets have decreased not increased. Thus, these countries saw no way to achieve a "Program of Sustained Growth" economically.

Lessons Learned

What are the lessons learned from the failure of the

Baker Plan? And, how might they be applied today, since the same debt crisis that US Treasury Secretary Baker attempted to address in 1985 is still prevalent and threatening to US national security interests? First, additional lending is not the answer. The programmed $29 billion was never collectively raised and economic conditions are no better off today than they were in October 1985. Even if the needed financial resources were available, the lending institutions were and still are reluctant to lend more questionable value loans. And, the borrower still does not want to go deeper into debt without some ultimate assurance of a way out of the debt dilemma.

Second, sustained economic growth would allow these debtor countries the time needed to get on firm financial footing. But, when the Baker Plan failed to address either of the root causes--the debts themselves and the global economic situation, it failed to solve the problem and allow the desired economic recovery. It is conceivable that addressing one cause while not addressing the other could lead to a permanent debt solution. But, the Baker Plan showed that failure to address either issue is not the answer. As one analyst said, "Unless Baker can show that

his plan departs significantly from the old approach--squeezing Third World economies to the limit of political tolerances--how can anyone expect the debt crisis to be better managed in the future than it was in the past?" (36:59)

CHAPTER IV

RECOMMENDATIONS

> The security and stability of the Americas are deeply threatened by Latin America's economic problems....The countries of Latin America and the United States are potential partners, but they are increasingly at odds. The United States should adopt policies that respond to Latin America's needs. New approaches are required to resolve the hemispheric crisis of debt and growth and to reinforce the region wide turn toward democracy. (23:18)

If one assumes the best foreign policy approach is to "respond to Latin America's needs," and this author does, then, what is the best U.S. foreign policy strategy to help resolve this "hemispheric crisis of debt?" Before presenting a recommendation, several key influencing factors, supplemental to the lessons learned in the previous two chapters, must be considered in arriving at a plausible solution.

Unlike the Alliance for Progress era, Latin American nations today are more prosperous, better integrated into the world economy, and much more involved in international politics. Few, if any, Latin American nations are still "banana republics." While the inequities of the haves and have nots still exist in Latin America, democracy in that

region has accelerated demand for economic growth that cuts across class, region and ethnic lines. (23:1) With U.S. assistance and cooperation, Latin Americans truly desire to resolve their dilemma.

Latin America's means to pay its debt lies in the success of its exports of primary products and raw materials. As discussed earlier, these exports are worth less today when compared to what these countries must pay for imports. Regional commodity prices that should have increased during the early to mid 1980s actually devalued about 11 percent. And, "There is general agreement that the prices of primary products exported by the region will probably continue to weaken, thereby compounding repayment problems." (12:129)

Demand for Latin American exports is also decreasing. Sugar, textiles, wheat, corn, meat and steel (all major Latin American exports) face increasing developed country protectionist measures as these countries, including the United States, try to protect or subsidize their own industries. This is especially true of the larger Latin American nations that now export industrial and agricultural products that can successfully compete with those from the United States. Latin American export items such as coffee,

sugar, cocoa and bananas have also declined due to decreased consumer demand in importing nations. Other regional export items have simply declined due to slower economic growth by developed industrialized nations. Even bulk export items like iron, copper, bauxite and cotton struggle in the world market as demand shifts to incorporate final product materials that offer lower cost substitutes, e.g. technological advances such as plastics and synthetics. It is not surprising then that in terms of total world trade, that Latin America's market share significantly decreased from 12.4 percent in 1950 to 5.9 percent in 1982, and has not substantially improved today. It is highly questionable given these conditions, if Latin America, even with the most aggressive export efforts, can continue to generate, on a permanent basis, trade surpluses sufficient to cover its formidable yearly interest payments. (22:25;12:132-133,136; 24:4)

As global economic growth slowed in 80s, interest rates remained about six percent higher than inflation, making the cost of servicing debt in Latin America extremely high in real terms. To meet IMF loan conditions and to sustain economic growth given the export situation, Latin

American leaders imposed sharp curtailments of imports and strict austerity programs designed to reduce consumption. These austerity measures included devaluation of their currencies, phasing out subsidies, increasing the prices of public utilities, restraining wage increases, reductions in the size of the public sector, increased interest rates and adoption of liberalized trade, investment and market-oriented policies. However, the combined impact of reduced export prices, debt servicing and these austerity measures had a negative long-term impact. Investments needed internally to maintain infrastructure (roads, telephones, services etc.) had to be postponed hampering production efficiency which, because of import restraints and depleted working capital, was already below capacity. The results for Latin America have been high inflation, slow growth, reduced standards of living, underemployment, and reduced health and education services. "With double-digit unemployment, more than half the working population holding only part-time jobs, and no social security safety net, the government of debtor nations are clearly sitting on a social powder keg." (6:266)

New sources of investment capital need to be found to accommodate Latin American economic expansion. However,

sources of capital today are much harder to find. "Externally (to Latin America), new financing is virtually unavailable, as commercial creditors, already worried about their present exposure to Latin American debtors, are understandably reluctant to make new monies available." (22:25) That became obvious in the failure of the Baker Plan. Financial assistance from bilateral and multilateral institutions like the World Bank or IMF is insufficient to meet the requirements for large debtor nations like Mexico and Brazil. Direct foreign investment, the last possible source of investment capital, is unlikely,

> ...as potential investors remain unwilling to commit funds to nations whose debt situations oblige them to impose tight control over the flow of funds, goods, and services across their borders. Furthermore, direct foreign investment is likely to flow to those nations that need it least, that is, to countries whose risk ratings are relatively strong. (22:25-26)

Any plausible solution must also consider the United States interests and mind set. For example, "Even if debtor nations were able to generate trade surpluses sufficient to meet projected repayments, it is doubtful that Western nations could continue to absorb such surplus without provoking greater protectionism." (22:31) This is especially true of the United States, the leading importer

of Latin American products. Strong U.S. protectionist measures, especially in areas that compete with labor intensive and non-modernized American industry, will continue to restrict Latin American exports into the United States thus preventing Latin Americans from earning the foreign exchange they need to pay back their loans.

The United States today is also faced with an internal budget deficit of over $150 billion--the world's largest debt, even exceeding Brazil's. The requirement to finance that deficit draws increasing pressure to lower the value of the dollar and raise interest rates thereby reducing U.S. spending. Both negatively impact Latin America's ability to meet its debt servicing payments since all such loans are tied to the value of the dollar. More importantly however, Congress and the President are being increasingly pressured into either making voluntary selective budget cuts or face automatic across the board mandated expenditure reductions under the Gramm-Rudman-Hollings Act. Such budgetary realities make it highly doubtful that a massive Latin American aid program; e.g. anything similar to the monetary obligation of the Alliance for Progress, would be proposed much less Congressionally approved.

The U.S. budget deficit also raises another issue. If the US is unwilling to aggressively tackle its own internal debt problem, as the Reagan administration has demonstrated and the new Bush administration indicates, how can one hope for a meaningful concerted effort to realistically solve a more complicated regional export-import balance and global fiscal interdependence (if that is a plausible hemispheric solution).

The issue of time factor and American public support must also be taken into account. Specifically, American public support and interest wanes for any program or action which does not have short-term success or marked results. For example, limited results to show for its half decade of monetary commitment resulted in drastically reduced Alliance for Progress funding support in the late 1960s.

Other factors, which more than anything else stress the urgency of the debt crisis, must also be taken into consideration. The conditions under which Treasury Secretary Baker unveiled the Baker Plan have not subsided. Prolonged economic decline in Latin America could have severe international consequences. Complete debt repudiation by one Latin American country could have a

domino effect within the region. If, because of heavy debt servicing, rising costs of its imports, falling demand or protectionist measures against its exports, either Brazil or Mexico, the two largest Latin American debtor nations, defaulted on their loans the effect on the United States would indeed be serious. "Simultaneous default by several major Latin American countries would severely hurt individual US banks and could harm the US banking system and even the international financial order." (23:11)

That ominous threat is indeed growing. The Cartagena Group, an informal forum of 11 Latin American nations founded to formulate and coordinate regional debt policies, have vocally announced that member nations should unilaterally reduce interest payments to below market rates (similar to what Mexico threatened and Peru has actually done by limiting debt service payments to 10 percent of their export earnings). This indication of growing Latin American dissatisfaction to what they consider inadequate responses by commercial creditors, creditor nations and multilateral lenders to the region's external debt problem and severe limitations of financing new growth should not be taken lightly. The consensus is widening among Latin American governments that additional loans, such as those

contemplated by the Baker Plan would do little to solve long-term structural problems. "For many Latin American governments, while it is clear that debt relief does not represent an adequate substitute for fundamental economic reforms capable of creating new wealth and ending capital flight, debt relief is of paramount political importance." (22:26)

Adverse consequences for Latin American democratic regimes are surely likely if the debt service burden is not reduced and sustainable growth is not resumed. Insurgent movements against incumbent ruling parties reminiscent of the 1960s will increase. Strong vocal support for expulsion or nationalization of U.S. in-country firms is not unlikely. Needless to say, a broad deterioration in United States-Latin American relations would result. "Such intensified inter-American conflict is by no means inevitable, but it is a plausible course if the hemisphere's economic crisis is not resolved." (24:42) Therefore, for all of the above reasons, a "take no action" strategy approach is not a plausible alternative.

Given the interdependence and the macro and micro-economic complexity of the issues at hand, the best

course of action for the United States to take, if it is serious about its security interests in the Western Hemisphere, is to devise a policy and strategy that realistically addresses three essential Latin American debt crisis elements; namely, structural reform, economic growth and debt relief.

Structural reform and economic growth, such as those proposed and alluded to respectively by the Baker Plan, must be integral to any debt resolution strategy. Many in Latin America sincerely believe that "state led models of economic development are deficient in many ways and that gradual adoption of market-oriented policies can contribute substantially toward sustained economic growth." (22:31) Economic growth is an essential element not only to help resolve the current fiscal dilemma, but also as a hedge against return to the debt crisis. Structural reform and austerity measures offered by the Baker Plan were not attractive because no long term solution to the debt crisis was seriously addressed.

But the last element, debt relief is a necessity and essential element not addressed by the Baker Plan. This is the crux of the crisis destabilizing Latin America today. Now to specifics.

I propose the United States aggressively spearhead the establishment of a multi-interest forum comprised of the IMF, World Bank, finance ministers of both debtor and creditor nations and key commercial banking experts. The charter of such a forum would be to devise a flexible "guide" formula for restructuring existing debts. Elements of that formula would be to limit debt service obligations to a reasonable share of export earnings and national cash inflows from other sources, lengthen loan maturities, lower interest rates and/or selectively write off existing debts. This "guide" formula would then be used in follow on meetings with members of the IMF, World Bank, debtor nations and creditors to establish on a case-by-case basis exact percentages and conditions for debt resolution.

In any essentially one-on-one debt repayment negotiations, concessions made to one Latin American country must be considered as possibly being made to all. Each sovereign debtor will abound with ample justification for more liberal terms and demand the same treatment. Likewise, the cumulative effect on the stability of the international credit markets must, and I'm sure will, be carefully weighed. However, the nature of the collective participants

of both groups should ensure that the solution is not so radical in implementation as to cause a world economic crisis or cataclysmic world depression. Both factions must and should be willing to compromise.

Before being hurriedly dismissed as impossible, and although suggestive of a total "give-in" to the exact position several Latin American governments have advocated in the past, let me expound on those formula elements in greater detail.

First, a definitive relationship between debt service payments and export-import surplus is long overdue. In Latin America today many debtor nations face debt service ratios well over the 20-25 percent range, already considered very high and risky. Such ratios are not sustainable long-term without, as we've witnessed, severe internal repercussions. The exact percentage, if any, while determined on a country-by-country basis should stipulate that the balance of the export-import surplus should be capitalized.

Element two. This balance, that which is not used to service the debt, should be used solely to stimulate internal growth. The debtor country must use this money for internal investments to improve productivity such as

infusing capital into the private sector, or revitalize/ initiate projects; i.e. electric dams, transportation and communication systems etc., to stimulate greater productivity. To ensure compliance, an international overseer authority must be established. This element is essential because no permanent solution can be found without improving these nation's internal economic infrastructure. Since external sources of revenue for capital investment are not to be found, allowing less funds to leave the region via debt service payments is the only conceivable alternative.

Element three in the formula is a case-by-case write off of some determined portion of the debt, if any is determined appropriate. While this certainly will be opposed by the commercial banks and Western industrialized governments, facts of life must be faced. The crux of the Latin American problem is the extent of the debt itself. Lending more money, as in the Baker Plan, only compounds the problem. The debt itself is growing faster than net export proceeds and Latin American nations cannot make any substantial headway on relieving that debt. Solely reducing the rate of interest to be paid or by setting percentage ceilings allocated to debt service are not, by themselves,

totally sufficient. Loan write offs are not new in American economic life.

> As recently as 1953, the United States reduced Germany's debt by two thirds and stretched the repayment over 35 years at a concessional interest rate of only three percent. Although the circumstances were clearly different, this last example shows that the costs of adjustment can be distributed among creditors and borrowers instead of being borne exclusively by the debtors, as is currently the case. (6:260)

Remember also, that while many commercial banks, as discussed under the Baker Plan, have not written OFF their lower grade foreign loans, they have written DOWN (e.g. sold the loans at reduced rates or hold cash in reserve to soften the effect should the loans default) some of them to reduce their exposure. Any write off would have to undergo close case-by-case scrutiny to ensure the debtor nation could not further reduce imports, adjust its economy or generate additional exports. Further, as a hedge and means to protect the lender, a clause should be included that stipulates, "in the event a country enjoys a sudden, unexpected increase in foreign exchange receipts, for example because of a jump in copper prices, debt cancellations would be reviewed." (6:273) Similarly, debtor countries may request a matching clause to protect them in the event of a major disaster or unexpected major economic

upheaval. Again, this is not revolutionary as Venezuela negotiated a special emergency clause when it renegotiated its foreign debt.

The tie of export earning percentages, lowered interest rates, extended maturity and loan write offs allows individual nation flexibility yet steady attainment of debt relief with simultaneous economic growth. Such an approach avoids the pitfalls of trying to control or manipulate export-import balance and global economic interdependence factors. In this light, such a proposal is therefore relatively simple and stands a better chance of success.

Other factors are also essential to success. First, like the Baker Plan, the Latin American debtor nation must accept internal structural policy changes designed to promote growth, reduce internal inflation, discourage capital flight, attract foreign investment and encourage divestment of nonefficient state owned industries. The commercial bankers were correct in this positive aspect of the Baker Plan. The difference of these Latin American "perceived additional austerity" measures is that Latin American's can now see a bona fide solution to their problem and one in which they have a significant input.

Second, and equally important, the forum for such

radial changes must NOT be the United States in one-on-one meetings with the Latin American countries, but rather an international forum sponsored by the World Bank or IMF. This is imperative if the U.S. is to avoid any impression of direct intervention in Latin American internal affairs. These international agencies already have the expertise and highly qualified staffs in this field. Besides not having individual country interest bias, they are much more qualified in reviewing debtor country investment strategies and advising on structural reforms needed to increase production, exports, efficiency and employment. The significant change here is that besides being the overseer of the formula case-by-case decisions and implementation, they must take a more active role in ensuring that withheld service payments are indeed reinvested appropriately in the internal economy of the debtor nation.

Lastly, such a proposal asks a lot of the United States commercial banking institutions. In return for their support, U.S. tax laws should be altered to allow an extended tax benefit of any such Latin American loans being written off. This is not a revolutionary idea in the banking industry. In a number of European countries,

banking and tax legislation encourages the establishment of sizable loan-loss provisions. (6:271) United States tax codes can be written to allow such tax breaks for specifically designated loans.

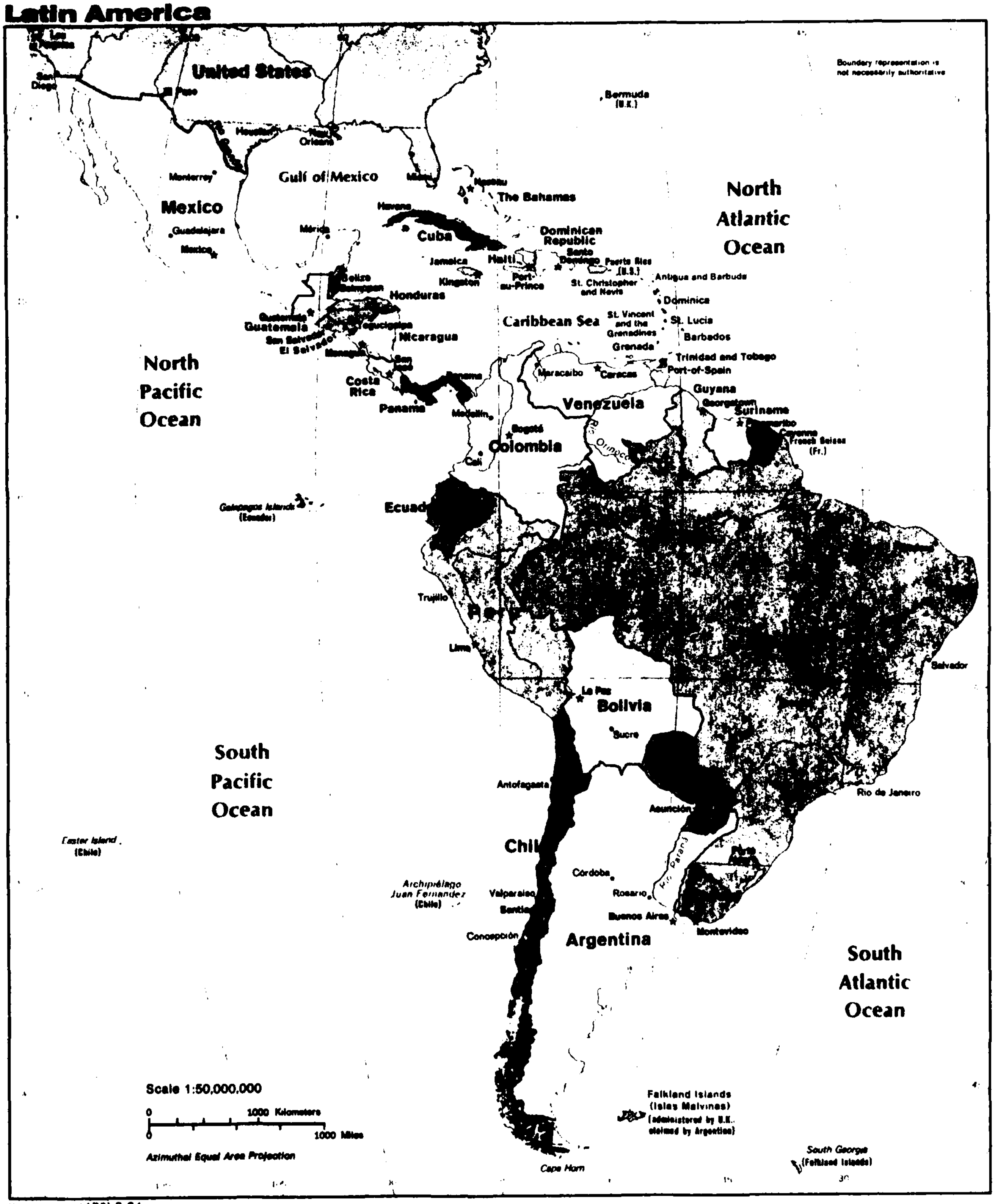
Have the lessons learned from the Alliance for Progress and the Baker Plan been adequately taken into account? Yes. The goal of such a strategy is resolution of Latin America's debt crisis by attacking the debt itself and by not attempting to manipulate economic trade relationships. This goal is attainable within current economic forecasts if the U.S. and Latin American nations have the resolve and commitment to see it through. Such an approach is also not overly ambitious because it does not attempt to tackle both the debt itself and global export-import econom[illegible] Strategy duration is conditional on how fast the debts are written off, how much of a percentage is recapitalized back into these countries, how fast they recover internally and how much the cumulative effect must be spread out to avoid a global depression. The author's estimate is it will take a decade to get the collective Latin American debt down to a $10 billion range. That forecast, although realistic, is not optimum considering the propensity for dwindling U.S. public support

of long term programs. However, no other option offers to take less time with a higher probability of success. And, such a strategy proposal considers both the Latin American element, by having them as active participants in the process, and current fiscal reality, by not proposing a large economic aid package or additional loans as the solution.

In summary, in the 1960s the United States embarked on a noble, ambitious crusade with our southern neighbors to stamp out illiteracy, drastically decrease poverty, redistribute income and foster a stabilizing democratic system throughout Latin America--a system firmly resistant to communist influence. That ambitious dream failed for many reasons, not the least of which was Latin American unreadiness for such a dramatic transformation. In the mid 1980s, James Baker introduced a planned "Program of Sustained Growth" to resolve the global debt crisis. The plan failed because it only proposed a "bandage fix to a festering wound." That wound is still with Latin America in 1989 and threatens the core foundation of Latin American democratic thought and values. The Alliance for Progress and the Baker Plan were not wasted efforts if we learned our

lessons well, and apply what we learned to our hemispheric foreign policy challenge of the late 1980s and early 90s. As partners in and with the full cooperation and integration of our Latin American neighbors, let us together solve their most pressing problem--the staggering debt crisis. This paper recommends a foreign policy strategy to solve that crisis so that together we can grow economically and further freedom and democracy for the present and future generations.

Latin America



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THIRD WORLD DEBT

COUNTRY	FOREIGN DEBT (in billions)	1985 INTEREST (in billions)
*Brazil	$103.5	$11.8
*Mexico	$ 97.7	$10.0
*Argentina	$ 50.8	$ 5.1
*Venezuela	$ 32.6	$ 4.1
Phillippines	$ 27.4	$ 2.1
*Chile	$ 21.9	$ 2.1
Yugoslavia	$ 20.0	$ 1.7
Nigeria	$ 18.0	$ 1.8
Morocco	$ 14.4	$ 1.0
*Peru	$ 13.9	$ 1.3
*Colombia	$ 13.9	$ 1.3
*Ecuador	$ 7.9	$ 0.7
Ivory Coast	$ 6.3	$ 0.6
*Uruguay	$ 4.9	$ 0.5
*Bolivia	$ 4.2	$ 0.4
1985 TOTAL	$437.4	$44.5

* Latin American countries

Data extracted from "Why Baker's Plan Won't Work," Fortune, December 23, 1985.

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